

INTERNAL REVENUE SERVICE
TE/GE Division

DEPARTMENT OF THE TREASURY
1100 Commerce Street
Dallas, Texas 75242

Date: MAY 16 2000

Employer Identification Number:
[REDACTED]

Contact Person:
[REDACTED]

Contact Telephone Number:
[REDACTED]

In Response, Refer To:
[REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code.

You incorporated under the laws of [REDACTED]. Your purposes were to engage in educational, scientific research and charitable activities in the public interest in order to help develop each person's highest potential as a human being.

Your initial board of directors consisted of [REDACTED], [REDACTED], [REDACTED] and [REDACTED].

Your activities were described as follows:

A personal-growth environment developed through [REDACTED] workshops each month where attendees are encouraged to draw out the creativity in each other by creating an atmosphere of honesty, self-awareness, unconditional love and genuinely-caring communication and discussion. Workshops are conducted by [REDACTED] or by other group facilitators trained by [REDACTED]. About 40% of your time and resources are focused on this activity.

The workshops and classes include topics such as assertiveness, effective communication, dream work, public speaking, self esteem, and other personal-growth oriented topics. About [REDACTED] % of your time and resources are focused on this activity.

Professional services such as career and relationship counseling, [REDACTED], one-on-one assistance with assertiveness

[REDACTED]

and self-esteem skills, and other services are designed to encourage personal growth. About 20% of your time and resources are focused on this activity.

You maintain a world-wide-web national database of holistic, alternative and wellness-oriented practitioners. About 10% of your time and resources are focused on this activity.

You indicate in your application that you will not have members. Your by-laws indicate you will have no members, regardless of the use of the term "members" in advertising materials.

Along with activities that would qualify as educational, your calendar of monthly events includes such activities as happy hour, birthday bash, Halloween party, [REDACTED] ([REDACTED]), potluck gathering, and [REDACTED] ([REDACTED]). Some events are restricted to members only per the calendars. Of the [REDACTED] events in [REDACTED] and [REDACTED] in [REDACTED], [REDACTED] and [REDACTED] respectively were for members only. Of those [REDACTED] and [REDACTED] events for members only, [REDACTED] and [REDACTED] respectively appeared to be significantly or entirely social affairs.

One of your primary teaching programs is watching movies and discussing traits, life lessons, etc. that can be learned from such movies. On the other hand, during one such program where a movie was viewed, you [REDACTED] and [REDACTED].

Your primary source of revenue comes from fees charged for the services you offer. You seek some donations through personal requests and a donation basket located at some of your free events.

You are a successor to a [REDACTED] which was operated for [REDACTED] years by [REDACTED]. You have indicated that the [REDACTED] had managed to stay afloat by postponing the payment of wages to [REDACTED] and a [REDACTED] worker.

You provided a Tentative Agreement for Transfer of Ownership approved [REDACTED]. This agreement indicated that after items were appraised, you and [REDACTED] would work together to create a list and terms for the transfer that were acceptable to both. You provided a Transfer of Ownership agreement for transfer of [REDACTED] to you as approved [REDACTED], but indicated the transfer was effective as of [REDACTED]. The agreement indicates that the donation includes all physical and non-physical assets and liabilities of the proprietorship as of [REDACTED], estimated to have the net value of \$[REDACTED]. Assets valued at \$[REDACTED] consisted primarily of donated

[REDACTED]

tangible assets worth \$[REDACTED] and non-physical (intangible assets) items worth \$[REDACTED]. Included in tangible assets donated were items of custom software worth \$[REDACTED]. The intangible assets included [REDACTED] worth \$[REDACTED] and [REDACTED] worth \$[REDACTED]. Liabilities consisted primarily of \$[REDACTED] in loans payable. You indicated that no appraisal was required because assets were donated rather than sold, which had been verified by a telephone call to the IRS' Customer Service Department for exempt organizations.

Your activities are generally carried on in a residential apartment leased by [REDACTED], who is your [REDACTED]. All expenses for the apartment are paid by you and are shown as your primary expense in your financial data. You indicate that [REDACTED] lives there as a condition of employment. You have attempted to get the apartment lease in your name, but the lessor was unwilling.

Your financial data indicates losses for the periods from [REDACTED] through [REDACTED] totaling \$[REDACTED]. Your fund balance at that time was a negative \$[REDACTED]. You show loans owed of \$[REDACTED] on your balance sheet. Subsequent changes and corrections were made to financial data.

In response to our letters, you indicated the following:

There were no formal instruments for loans made to the former proprietorship and most of the persons making the loans never really expected to recoup their money.

The value of any organization is based on reputation of excellence of service and the value of providing those services at an affordable price.

You needed a place to conduct activities and having [REDACTED] there would provide security and someone available to open and close on a daily basis.

[REDACTED] you provide is a well-established form of wellness and alternative healing.

Social events offer a chance for healthy interpersonal interactions that are part and parcel of the mission of the organization. The percent of organizational time expended on these events is estimated to be less than 5%.

Custom software transferred to you by the proprietorship was valued at \$[REDACTED] according to an appraisal you provided.

[REDACTED]

All workshops and books developed by [REDACTED] remain his intellectual property and would be owned by [REDACTED].

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

The "not more than an insubstantial part of its activities" standard of section 1.501(c)(3)-1(c)(1) of the regulations can be understood by reference to Better Business Bureau v. U.S., 326 U.S. 279 (1945), which held that an organization which engaged in some educational activity but pursued nonprofit goals outside the scope of the statute was not exempt under section 501(c)(3) of the Code. The Court stated that an organization is not operated exclusively for charitable purposes if it has a single noncharitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. Thus, the operational test standard prohibiting a substantial nonexempt purpose is broad enough to include inurement, private benefit, and operations which further nonprofit goals outside the scope of section 501(c)(3).

Hancock Academy of Savannah, Inc. v. Commissioner, 69 T.C. 488 (1977), in which the court found that consideration given by a newly formed school in exchange for the goodwill of an older proprietary institution

[REDACTED]

was excessive, was denied exemption. The case stated in part "...for a nonprofit school to pay for goodwill, generally a measure of the profit advantage in an established business, is anomalous. Although payment for goodwill may be appropriate for a private organization designed to make money to support unrelated exempt purposes or to take over a formerly highly profitable business to be operated thereafter entirely for exempt purposes, this Court is hard pressed to conceive of a situation where payment for goodwill to take over an unprofitable business would be appropriate. To the contrary such a payment under usual circumstances necessarily would cause the earnings of the corporation to inure to private individuals."

Spanish American Cultural Association of Bergenfield v. Commissioner, T.C. Memo 1994-510, holds that an organization does not qualify for exemption under section 501(c)(3) of the Internal Revenue Code because its social activities were more than insubstantial in comparison to its charitable activities.

Revenue Ruling 77-366, 1977-2, C.B. 192 indicates, an otherwise qualifying organization which arranges and conducts winter-time cruises during which activities to further religious and educational purposes are provided in addition to extensive social and recreational activities, is not operated exclusively for exempt purposes and does not qualify for exemption under section 501(c)(3) of the Internal Revenue Code.

Revenue Ruling 76-441, 1976-2, C.B. 147 indicates the assumption by a non-profit organization of liabilities and assets of a for-profit entity can result in inurement when the value of the assets is exceeded by the amount of the liabilities and both organizations are controlled by the same individual or individuals.

Revenue Ruling 55-231, 1955-1 C.B. 72, denied exemption under section 501(c)(3) of the Internal Revenue Code to an organization that promoted intellectual property of the incorporator.

Section 119(a)(2) of the Internal Revenue Code provides that there shall be excluded from the gross income of an employee the value of any lodging furnished to the employee, the employee's spouse, or any of the employee's dependents by or on behalf of the employer for the convenience of the employer, but only if the employee is required to accept such lodging on the business premises of the employer as a condition of employment.

Section 1.19-1(b) of the regulations provides that the value of lodging furnished to an employee by the employer is excludable from the employee's gross income if three tests are met:

- [REDACTED]
- (1) the lodging is furnished on the business premises of the employer;
 - (2) the lodging is furnished for the convenience of the employer;
 - (3) the employee is required to accept such lodging as a condition of employment.

You consider social activities conducted as part of other programs or by themselves as a part and parcel of the mission of your organization. You indicate a small percentage of time devoted to social activities. You consider [REDACTED] to be therapy to promote wellness and alternative healing. You consider your web database of practitioners to be an exempt activity.

Social activities can jeopardize exemption as evidenced by Spanish American Cultural Association and Revenue Ruling 77-366. Social activity being only 5% would not seem correct based on your calendars and social activity conducted in conjunction with exempt programs. For example, your [REDACTED] calendar shows [REDACTED] events with those events on [REDACTED], [REDACTED], and [REDACTED] appearing to be social, while other events such as the movies and restaurant activity have some social activity. Practicing something you learn in an educational program at a social event would not make that social event educational. Social events being restricted to members more often than other events emphasizes the social aspect of those events by restricting attendance to a smaller, closer, supportive group.

Providing [REDACTED] for a fee is a business and would not be exempt merely because it promotes health. A doctor who operates a medical practice providing healthcare is promoting health, but is not exempt because it is a business.

The provision of web database information on practitioners for a fee is a form of advertising for those individuals and furthers no exempt purpose.

Each of the above activities may be insubstantial when considered separately, but become substantial when taken as a whole. Therefore, you have more than insubstantial non-exempt activity and would not qualify for exemption as indicated in Better Business Bureau v. U.S., Spanish American Cultural Association of Bergenfield v. Commissioner, and Revenue Ruling 77-366.

You have failed to provide independent valuation of assets to show that assets assumed exceed in value liabilities assumed. Information on the [REDACTED] indicates it was not profitable and existed primary on loans and postponement of wages. The prior earnings history of the [REDACTED] and the earnings history during which you operated

[REDACTED]

the activity before formal transfer indicate a losing venture. The liabilities assumed far exceed the value of any tangible assets. Some of the tangible assets were more personal than business. You have not shown the correlation between the software development cost and fair market value of the software. Software packages could be purchased on the market for a tiny fraction of the cost you show as development cost. For example, your appraisal shows the cost of development for the mailing list portion of the software as being \$[REDACTED]. Would anyone really pay that much for mailing list software? Estate of Palmer v. Commissioner, 839 F.2d 420, 424 (8th Cir. 1988) indicates that reproduction cost (or, in this case, development cost) is an appropriate measure of value only when the taxpayer establishes a probative correlation between such cost and fair market value of the property. You have not shown such correlation. Further, the software valuation was not considered in approving the transfer and your financial data showed custom software only to be worth about \$[REDACTED]. Other intangible values have not been substantiated based on proprietorship history.

✓ The value of liabilities assumed is questionable. No original loan documents to support the loans were made and statements made indicate it was not expected all loans would be repaid. In fact, many of the loans had been outstanding for years prior to transfer, with no payments having been made during those years.

✓ You have failed to substantiate the value of the assets and liabilities assumed from the sole proprietorship, and that the value of assets assumed exceeded the amount of liabilities assumed. Therefore, based on Hancock Academy of Savannah, Inc. v. Commissioner discussion of worth and denial in that case and Revenue Ruling 76-441, your assumption of the sole proprietorship serves the private benefit of [REDACTED] and provides emurement to him.

✓ All the board members had loans out-standing to the proprietorship at the time of transfer. Thus, they would have a vested interest in the transfer if the loans could be turned into contributions to you resulting in tax-deductible contributions for them after the transfer.

Thus, the assumption also serves the private benefit of the board members who had out-standing loans to the proprietorship.

The issue of whether or not lodging is furnished for the convenience of the employer, or whether the employee is required to accept the lodging to properly perform his or her duties, is primarily a question of fact to be resolved by a consideration of all the facts and circumstances. United States Junior Chamber of Commerce, 334 F.2d at 663 [64-2 USTC ¶13,371; Olkjer v. Commissioner, 32 T.C. 464 (1959) [CCH Dec. 23,618], acq., 1960-1 C.B. 5]; Stone v. Commissioner, 32 T.C. 1021 (1959) [CCH Dec. 23,708]. As explained by the court in Dole, 43 T.C. at 706 [CCH

Dec. 27, 253], "[t]he standard prescribed by Congress is not subjective. It is objective. The employer's state of mind is not controlling."

The exclusion of the value of [REDACTED] lodging from his employee's gross income under section 119 of the Internal Revenue Code is not appropriate based on the use of facts and circumstances as indicated should be done in court cases identified above. The facts and circumstances considered in this case include the following:

- [REDACTED] rented the apartment, which is a residential apartment, for his private residence prior to your use of that apartment to conduct your activities.
- You have not identified duties that would seem to require him to live there to properly perform those duties.
- His living there was part of the negotiated Transfer of Ownership Agreement agreed upon in transfer of the proprietorship rather than being a requirement determined after the transfer.
- His lodging at the apartment is more for his convenience than for your business convenience since you are unable to pay him a salary and he has no source of income to afford the apartment otherwise.
- His influence in decision-making for the organization.

/ Not reporting the value of lodging serves the private benefit of [REDACTED] and results in inurement to him by providing lodging that you pay for him.

/ You have indicated [REDACTED] is to own the rights to workshops and books he develops. His ownership of the workshops and books and your promotion of them would serve his private interest and not further exempt purposes as indicated in Revenue Ruling 55-231, 1955-1 C.B. 72. Your references to policy of a major University would not be relevant since employees there do not have control of policies and any private benefit would be incidental when compared to public benefit served by the University. Also, it would seem that the value of the sole proprietorship would be further diminished since its value would depend on being able to use those workshops created for the sole proprietorship. If [REDACTED] left and decided to limit your use of workshops without paying intellectual property fees, your programs would be greatly reduced. Further, what workshops [REDACTED] owns are not sufficiently identified in documents to determine which are yours and which are his.

~~TOP SECRET~~

Thus, based on substantial non-exempt activity, inurement and private benefit as discussed above, you do not qualify for exemption under section 501(c)(3) of the Internal Revenue Code.

Accordingly, you are not exempt and should file Form 1120.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. The enclosed Publication 892 gives instructions for filing a protest.

If you do not file a protest with this office within 30 days of the date of this report or letter, this proposed determination will become final.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides in part that, "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Court of Claims, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

If this determination letter becomes a final determination, we will notify the appropriate State Officials, as required by section 6104(c) of the Code, that based on the information we have, we are unable to recognize you as an organization of the type described in Code section 501(c)(3).

If you agree with these conclusions or do not wish to file a written protest, please sign and return Form 6018 in the enclosed self-addressed envelope as soon as possible.

Sincerely,

Steven T. Miller

Steven T. Miller
Director, Exempt Organizations

Enclosures:
Publication 892
Form 6018